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IN THE

Supreme Court of the United States

October Term, 1965.

No. 21.

THE UNITED GAS IMPROVEMENT COMPANY, LONG ISLAND LIGHTING COMPANY, and PHILADELPHIA ELECTRIC COMPANY,

Petitioners,

v.

CALLERY PROPERTIES, INC., J. R. FRANKEL, MARGARET HUNT HILL, Trustee, J. RAY McDERMOTT & CO., INC., OCEAN DRILLING & EXPLORATION COMPANY, PLACID OIL CO., CAROLINE HUNT SANDS and LOYD B. SANDS, and THE SUPERIOR OIL COMPANY,

Respondents.

BRIEF FOR PETITIONERS, THE UNITED GAS IMPROVEMENT COMPANY, LONG ISLAND LIGHTING COMPANY, AND PHILADELPHIA ELECTRIC COMPANY.

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OCTOBER TERM, 1965.

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Petitioners,

v.

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BRIEF FOR PETITIONERS, THE UNITED GAS IMPROVEMENT COMPANY, LONG ISLAND LIGHTING COMPANY, AND PHILADELPHIA ELECTRIC COMPANY.

OPINIONS BELOW.

The Opinion of the Court of Appeals for the Fifth Circuit (R. 619) is reported at 335 F. 2d 1004 (1964). The Opinions and Orders of the Federal Power Commission (herein called "Commission") reviewed by the Court of Appeals (R. 550-93, 607-17), are reported at 30 FPC 283 and 30 FPC 682 (1963). The Commission stated that it was "in almost complete accord with the decision of the presiding examiner" and concluded that the examiner's decision, with certain modifications, should "constitute the decision of the Commission" (R. 556). The examiner's decision (R. 491-541) is reported at 30 FPC 304 (1963).

JURISDICTION.

The judgment of the Court of Appeals was entered on August 14, 1964 (R. 643-44). The Petition for a Writ of Certiorari herein was filed on November 10, 1964 and was granted on March 8, 1965 (R. 645), 380 U. S. 931. At the same time Petitions for Writs of Certiorari filed by the Federal Power Commission and by the Public Service Commission of the State of New York, attacking the same judgment on similar grounds, were granted and the cases consolidated for argument (R. 646-47), 380 U. S. 931. The jurisdiction of this Court rests on 28 U. S. C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U. S. C. § 717r(b).

STATUTES INVOLVED.

The statutory provisions involved are §§ 4, 5, 7, and 19(b) of the Natural Gas Act, 52 Stat. 822 (1938), as amended, 15 U. S. C. §§ 717c, 717d, 717f and 717r(b). These Sections are printed in Appendix "A," *infra*, pp. 1a through 6a.

QUESTIONS PRESENTED.

In 1954 this Court held that producer sales of natural gas in interstate commerce were subject to Commission regulation. *Phillips Petroleum Corp. v. Wisconsin,* 347 U. S. 672. In 1959 this Court held that when a producer application under § 7 for authority to make a new sale signals a situation not in the public interest—because the proposed price exceeds existing price levels or threatens to "trigger" price rises in other sales contracts—the Commission must, in the absence of a finding that the proposed rate is just and reasonable, either refuse to certificate the sale or issue a certificate conditioned to protect the consumer. *Atlantic Ref. Co. v. Public Service Comm'n,* 360 U. S. 378 (herein called *"Catco"*). In 1963 this Court held that the Commission might properly conclude that producer rate regulation could not be carried out by means of the separate examination of individual sale or producer costs, but instead upon an area basis. *Wisconsin v. FPC,* 373 U. S. 294. Pursuant to these decisions, the Commission is now engaged in a regulatory program whereby all cost, economic and other evidence bearing on the justness and reasonableness of rates for producer sales in a given area is heard and evaluated in comprehensive area rate proceedings under §§ 4 and 5 of the Act. At the same time, pending the promulgation of area rates, new sales by producers to a pipeline at higher than in-line prices are certificated under § 7 only if subject to refund and with appropriate safeguards against "triggering" area-wide price increases. The court below held that § 7 forbids the Commission to so divide its evidentiary investigation and to thus forestall triggering, but instead requires it to proceed on an individual sale, individual company basis, with the concomitant prolonged hearing of cost and economic evidence.

Therefore the questions presented are:

1. Does § 7 of the Natural Gas Act require the receipt in evidence of cost and economic evidence offered by appli-

cants which (a) is of the same type concurrently being received in an area rate proceeding involving the same applicants and sales and (b) has been examined as an offer of proof and found by the Commission to be of the same type as evidence rejected in earlier § 7 hearings as useless for initial price regulation and productive of administrative delay injurious to the consumer?

2. Does § 7 permit the Commission to condition the grant of a permanent certificate upon the applicant's reducing his contract initial rate to a rate no higher than the "in-line" price level for the area, thereby placing any subsequent increase above that level under a consumer-protective refund obligation?

3. Does § 7 permit the Commission to condition the grant of a permanent certificate upon the applicant's not filing under § 4 for rate increases above a level that would trigger a general price rise, until the Commission completes the determination of just and reasonable rates for the area?

4. Does § 7 permit the Commission, on remand of court-reversed grants of permanent certificates, to grant new permanent certificates conditioned upon the applicant's refunding the difference between the price ultimately authorized and the higher price collected under the invalid certificate?

STATEMENT OF THE CASE.

The Commission's decision is part of a viable and effective program of regulation, fair to producer and consumer alike, consistent with the needs of each, and adopted, after several false starts, pursuant to the direction of this and other Courts. The basic issue in the case is whether the Commission's decision was within its statutory authority.

The relevant facts are:

In June, 1957, the Commission, over consumer protest, issued unconditioned permanent certificates authorizing the *Catco* producers to begin a major new sale of natural gas in interstate commerce from fields located in off-shore Louisiana at an initial price of 21.4¢ per Mcf plus tax reimbursement. *Continental Oil Co.*, 17 FPC 880 (1957). This price was the highest ever contracted for in the area and was followed shortly by a general price rise for natural gas to the new high level. The consumer interest, represented by local distribution companies and State utility commissions, hotly contested these certificates and sought court relief. Two years later this Court unanimously held the Commission's action invalid. *Catco*, 360 U. S. 378. But in the period between the Commission's unconditioned certification of the *Catco* application in 1957 and this Court's decision in 1959, the Commission in six separate formal hearings, involving a total of 69 producers, followed its erroneous approach and issued to the present respondents and other producers unconditioned permanent certificates for South Louisiana sales at initial prices ranging from 21.4¢ per Mcf, where no tax reimbursement was due, to 23.8¢ per Mcf including tax reimbursement. Each order, however, was timely appealed by consumer representatives—one or more of petitioners in Nos. 21 and 22—to the Courts of Appeals for the Third, Fifth, Ninth, Tenth or D. C. Circuits under § 19 of the Act, and some ultimately to this Court. In each case the consumer position was vindicated, the unconditional permanent cer-

tificate nullified, and the case remanded to the Commission for further proceedings.[1]

Subsequently, by order issued March 7, 1962, the Commission consolidated all 69 of the remanded producers dockets, together with five related dockets, for further proceedings, 27 FPC 482; see also 27 FPC 15. In its order, the Commission noted (1) that six weeks earlier, in the remanded *Catco* dockets, it had found the in-line level in South Louisiana for those contracts to be 18.5¢ per Mcf, plus 1.5¢ tax reimbursement where applicable, and (2) that the present petitioners in Nos. 21 and 22 were urging that the remanded proceedings be disposed of, without further delay, on the basis of the *Catco* determination on remand. Though conceding that there was merit to this position, the Commission nonetheless concluded that it "should afford the producers further opportunity to be heard," 27 FPC at 485, and accordingly set the consolidated proceeding for hearing.[2] At the same time, it notified respondents of their potential refund liability (R. 398).

At the outset of the hearing, the producer-respondents sought to introduce what the examiner described as "a tremendous mass of cost-type, economic and financial evidence" which he found to be "defective" and of "no real probative value" (R. 495). On motion of certain of the intervenors, supported by the Commission staff, the examiner

1. The cases and the court reversals are listed in footnotes 4, 5 and 6 of the opinion of the court below (R. 621-22). While nine Justices of this Court and eleven judges of various courts of appeals found error in the Commission's approach, only one judge, dissenting, did not, and he ironically became the author of the opinion here under review.

2. Prior to the commencement of the remanded hearings conferences were held between a number of the producer applicants and the intervenors, and proposed settlements were entered into and submitted to the Commission for its approval, which was forthcoming on July 30, 1962, 28 FPC 247. Although these settlements covered the bulk of the remanded applications, some producers—including respondents here—were unwilling to accept the settlement terms, and a hearing on their remanded applications was held before a presiding examiner on June 18-21, 1962.

ruled that such evidence was inadmissible. The examiner, however, received in evidence the producers' non-cost data showing the prices for all gas contracts in South Louisiana and the prices at which certifications were currently in effect (R. 208-28; Exh. X-42, R. 286-99).

Following the submission of briefs, the examiner on December 7, 1962, issued his decision (R. 491-540) in which he (1) reaffirmed his exclusionary ruling (R. 495-99); (2) concluded that the in-line price for the contracts here involved was 18.5¢ per Mcf, plus 1.5¢ per Mcf tax reimbursement where applicable (R. 499-509); and (3) directed that the producers refund, with interest, all amounts previously collected under the invalid and illegally issued certificates in excess of the appropriate in-line levels of 20.0¢ per Mcf or 18.5¢ per Mcf (R. 514-27).[3]

On exceptions to the examiner's decision filed by various parties, the Commission, in Opinion 398 issued July 17, 1963, affirmed and adopted the examiner's decision, though modifying it in certain respects (R. 556). And, based upon its findings that any rate filing to levels in excess of 23.55¢ per Mcf would cause widespread "triggering" of contract prices throughout South Louisiana, the Commission held that it would condition permanent certificates for contracts which called for increased prices above 23.55¢ per Mcf upon the applicant's not filing for increases above 23.55¢ per Mcf until July 1, 1967, or until the conclusion of the pending South Louisiana Area Rate Proceeding, Docket No. AR61-2, whichever is earlier. Applications for rehearing

3. The Commission's decision in the Permian Basin area rate case (Docket AR61-1, Op. 468 issued August 5, 1965) found a national replacement cost of gas of 16.5 cents per Mcf based on 1960 data found to be representative. Even adjusting for the difference in State taxes (1.3¢ per Mcf higher onshore Louisiana than in Texas) and pressure bases (14.65 and 15.025 psia in Texas and Louisiana, respectively), this equates to a price of less than 18.5¢ onshore Louisiana. But since the gas involved in this case is flowing under contracts dated before January 1, 1961, the ceiling price for this gas would be even lower under principles established in Op. 468, which reserve the incentive premium for gas committed after that date.

were filed, and on September 11, 1963, the Commission denied rehearing (R. 606-17).

Callery Properties, Inc. and the seven other producer-respondents here, appealed to the Court of Appeals for the Fifth Circuit. The United Gas Improvement Company, Long Island Lighting Company and Philadelphia Electric Company,[4] Petitioners in No. 21 and the Public Service Commission of New York, Petitioner in No. 22 were permitted to intervene. That court on August 14, 1964, reversed the Commission. First, it held that the Commission erred in excluding cost-type evidence. Despite the Commission's clear holding that such evidence would cause § 7 proceedings to bog down and become full dress § 4 or § 5 rate hearings and was not useful, in any event, in determining the public-convenience-and-necessity initial price in § 7 proceedings, the court below nevertheless held that such extensive evidence would have to be accepted. In so ruling, the court made no reference to the holding in *Wisconsin v. FPC*, 373 U. S. 294, that the Commission need not proceed in rate cases on the basis of individual company costs, or the fact that other cost and trend evidence was at the time of decision being heard in a lengthy area rate proceeding (Docket AR61-2) involving the very area—South Louisiana—and covering the very producers in the present case.

4. Under an agreement with the City of Philadelphia, The United Gas Improvement Company operates the municipally-owned Philadelphia Gas Works and related facilities, distributing 1035 Btu natural gas to some 600,000 customers in the City of Philadelphia. It also distributes gas to some 205,000 customers in other parts of Pennsylvania. Long Island Lighting Company, a public utility organized under the Transportation Corporation Law of the State of New York, distributes natural gas to some 361,000 customers in an area of 1,230 square miles on Long Island, New York. Philadelphia Electric Company, a public utility organized under the laws of the Commonwealth of Pennsylvania, distributes natural gas to some 240,000 customers in Delaware, Chester, Montgomery, Bucks and Lancaster Counties, Pennsylvania. All three distributors purchase substantial quantities of natural gas for resale from Transcontinental Gas Pipe Line Corporation and other pipelines which in turn purchase substantial quantities of gas from producers in South Louisiana.

Second, the court held that the Commission had no power by condition to impose a limited moratorium on the producers' exercise of their contract right to file rate increases above 23.55¢ until July 1, 1967, or the conclusion of AR61-2 (in which Commission staff and intervenor evidence supports a just and reasonable rate well below the in-line level found by the Commission herein). This holding was despite the unreversed Commission finding that any filing above 23.55¢ would trigger rate increases under other contracts. Finally, the court held that the Commission had the power to order refunds, but that the refunds could not be ordered down to the appropriate initial price level. Rather, it geared refunds to an as yet undetermined just and reasonable level, in the unlikely event that that level should turn out to be higher than the initial price level.

Petitioners sought review in this Court and certiorari was granted.

SUMMARY OF ARGUMENT.

Rate proceedings under §§ 4 and 5 of the Natural Gas Act have proved to be intricate and lengthy. Pending the determination of just and reasonable rate levels in area proceedings now in progress, the expeditious certification of new sales under § 7 of the Act, either by permanent or temporary certificates, consistent with full consumer protection, has become a crucial focus of the Commission's regulatory duties. In a series of major § 7 proceedings the Commission has followed the same regulatory approach used in the present case. Most of these cases are not final and would have to be retried if the several holdings of the court below were permitted to stand. These proceedings are summarized in Appendix "C" to this brief.

The decision of the Commission here under review, which conditioned permanent certificates to applicants upon a reduction of initial price to in-line field price levels and left investigation of cost and economic justification for contract rates to the concurrent area rate proceeding, was a reasonable exercise of its discretion and was in accord with consistent Commission regulatory policy approved by a number of courts of appeals; an earlier contrasting Commission policy of refusing to scrutinize initial price levels had been consistently reversed by the courts of appeals and this Court.

The decision of the court below, by calling for a plenary evidentiary hearing for all applications under § 7, has the inevitable effect of relegating the exigent initial regulatory act to an *ex parte* temporary certification procedure. The expeditious grant of certificates is required if pipelines are to obtain the gas to support their expansion programs. The Commission's present approach, condemned by the court below, accommodates the needs of each segment of the industry, while at the same time safeguard-

ing the legitimate interests of producers and consumers. Under this approach, producer-applicants can accept certificates calling for in-line prices and then file under § 4 of the Act for their contract prices. The higher prices, collected subject to refund, are open to justification in area rate proceedings. If the court below is sustained, the pipeline requirement for expedition will force resort to a form of *ex parte* temporary certification. The mischievous results of an *ex parte* approach have been noted by this Court. *FPC v. Hunt*, 376 U. S. 515.

The "in-line" level found by the Commission to be the proper level for conditioning the applicant's certificates, while hardly on the "low side," as called for by *Atlantic Ref. Co. v. FPC*, 316 F. 2d 677 (D. C. Cir. 1963), was supported by substantial evidence of record. The Commission's order therefore should be affirmed by this Court without the further delay injurious to the consumer which might be occasioned by a remand to the court below.

The procedural delays in the present case have required the Commission to protect the consumer by ordering refunds of excesses collected above the lawful public-convenience-and-necessity level. In so ordering, the Commission acted in accord with this Court's strictures in *Catco*, 360 U. S. 378, and in a manner consistent with its customary practice in ordering refunds of excesses above lawful rates. This practice has been affirmed by the Courts of Appeals. *Shell Oil Co. v. FPC*, 334 F. 2d 1002 (3rd Cir. 1964); *Hunt Oil Co. v. FPC*, 334 F. 2d 474 (5th Cir. 1964).

In accord with this Court's statement that the "triggering" of area-wide increases through the activation of "favored nation" clauses and other indefinite price escalation provisions was contrary to the public interest, *Catco*, 360 U. S. 378, at 391, the Commission below correctly conditioned applicant's certificates to forestall such triggering in South Louisiana pending completion of the concurrent area rate proceeding for that area. In so acting, the

Commission exercised its statutory authority confirmed by this Court in *FPC v. Hunt*, 376 U. S. 515, in the context of temporary certification. The court below improperly limited the *Hunt* case by distinguishing between the criteria for a temporary and for permanent certification. Neither the Act nor this Court makes such a distinction, and the reversal of the Commission on this ground should, in turn, be reversed.

ARGUMENT.

The Commission Actions to Achieve Effective Regulation and Consumer Protection Were Within the Administrative Discretion Conferred Upon It by the Natural Gas Act.

The Commission below held that any permanent certificate issued to the producer-respondents herein must be conditioned upon the charging of a price for these South Louisiana sales which did not exceed the going price for other like sales in the same area executed at approximately the same time. In so holding, the Commission affirmed the exclusion of a mass of cost and economic evidence. In the course of his opinion below, Judge Brown, for the Court of Appeals stated in his footnote 30:

> "For all we know, had the Commission received the proffered evidence, it would have held it to be wanting and that might well have been the end of the matter." (R. 632)

Ironically, the Commission did just that. Exceptions were taken to the examiner's exclusionary ruling; all the excluded evidence was a part of the record in the form of offers of proof under the Commission's rules; the Commission stated (R. 556) that it had made a "review of the record;" clearly it considered "the proffered evidence" and found it "wanting."

This action by the Commission was in line with and, in fact, compelled by an impressive series of clear decisions passing upon the certification of South Louisiana sales. See cases cited *infra*, pp. 25-26. Examination of the history of producer initial price regulation under the Natural Gas Act shows that the Commission's holding was not novel; moreover, it was necessary and well within the authority granted the Commission by the Act.

A. The Two Approaches to Initial Price Regulation: "SIGNAL" and "Deferred Regulation"

Phillips Petroleum Co., 10 FPC 246 (1951) was an investigation of a natural gas producer's rates under § 5 of the Natural Gas Act. When this Court in *Phillips Petroleum Corp. v. Wisconsin*, 347 U. S. 672, reversed the Commission's conclusion that it lacked jurisdiction to regulate Phillips' rates, the focus of regulatory attention was upon the justness and reasonableness of the existing rate structure of natural gas producers who sold to pipelines for resale in interstate commerce. The investigation dealt with the cost of gas already flowing in interstate commerce. However, the Natural Gas Act, also provides in § 7 that no natural gas company "shall engage in the . . . sale of natural gas . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity issued by the Commission . . . ." Therefore, under the logical extension of this Court's holding in *Phillips*, natural gas producers were required to obtain certificates for their new sales in interstate commerce to pipelines upon terms which comported with the public convenience and necessity.

Under the structure of the Natural Gas Act rate investigations under § 5, using the just and reasonable standard, provide for prospective adjustment in rates only. Therefore, if a producer obtains a permanent certificate under § 7 for a sale at the contract price fixed by the seller and the buyer, that price remains in effect until lowered prospectively under § 5, regardless of whether or not it exceeds the just and reasonable rate. When, after *Phillips*, it became apparent that rate investigations under § 5(a), such as that for Phillips, would involve lengthy hearings, consumer protection required that the focus on rates be shifted to the time of the initial entry of gas into the interstate market. If a gas sale were permanently certificated at a price level higher than ultimately found to be just and

reasonable, the producer would receive a windfall, since the Act provides no mechanism for recovering overcharges. *Catco*, 360 U. S. at 389-90.

By 1965 the Commission has only just found definitive just and reasonable rates for the first producing area, the Permian Basin of West Texas and New Mexico. When other pending area rate proceedings (those for Southern Louisiana, the Texas Gulf Coast and the Hugoton-Anadarko areas) are completed, just and reasonable rates will have been established for about 75% of the natural gas sold in interstate commerce. The Southern Louisiana proceeding is in the terminal hearing stage and the other proceedings are in the initial hearing stage. Thus the continuation of an effective hold-the-line approach in certificate cases is essential.

The history of the past eleven years since *Phillips* shows that pending the definitive establishment of just and reasonable rates there are only two approaches to producer regulation of initial contract prices possible under § 7 of the Act.[5] The Commission has used both at different times and the courts have passed upon both, approving one and rejecting the other. One approach, the first to be used by the Commission, *Cities Service Gas Co.*, 14 FPC 134 (1955),

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5. The Commission's Statement of General Policy, SGP61-1, issued concurrently with its *Phillips* decision, 24 FPC 537 (1960) and the start of the area system of regulation, has served as an expediting standard for administering the first approach to initial price regulation, described hereinafter. The Statement of General Policy set forth, *inter alia*, "guide-line" levels for initial rates for the 23 various areas of gas production. The Commission stated that these "guide line" or "ceiling" level were based on "all data available" to the Commission, including cost and field price data. In practical effect, as first promulgated the "ceilings" generally reflected the highest levels attained by field prices in the various areas. After hearing on the issue of initial price, the Commission has generally found the proper public convenience and necessity price to be *lower* than the guide line (which, for example, is 21.25¢ including tax for South Louisiana). In the absence of contest, however, the Commission will certificate sales either temporarily or permanently at initial prices at or below the "guide-line" ceiling levels.

involves the technique of comparing proposed initial prices with the prevailing level of prices in the area of the proposed sale. Where the price of the proposed sale conforms to the prevailing level, a permanent certificate is issued. Where it exceeds the prevailing level, a permanent certificate is issued only upon the condition that the initial price be reduced to the prevailing level.[6] Upon receiving a certificate with the price so reduced, the producer may then file for any permissible rate increase under § 4(e) of the Act, which permits the Commission to suspend effectiveness of the rate increase and permit its collection subject, however, to refund and an eventual rate investigation. This approach permitted fairly prompt disposition of certificate applications. The use of this approach by the Commission was early affirmed in the court of appeals. *Signal Oil & Gas Co. v. FPC*, 238 F. 2d 771 (3rd Cir. 1956), *cert. denied*, 353 U. S. 923. This first approach may be termed, for brevity, the "*Signal* approach."

The second approach, and the one initially followed in all the dockets involved in the present case was to certificate unconditionally any proposed sale of gas, even though the proposed price substantially exceeded prevailing prices, and to rely upon the prospective-only rate adjusting powers granted by § 5 of the Act. This facile approach made for even greater apparent speed in the disposition of producer certificate applications, since basically no investigation was required by the Commission. But this approach was rejected by the courts because of the delays incident to § 5(a) cases and the consequent damage to consumers in their inability to recover past overcharges. In the celebrated *Catco* case the Commission at first used the conditioning (the *Signal*) approach, *Continental Oil Co.*, 17 FPC 732 (1957), but upon representation by the producers that unless they received unconditioned permanent certificates

6. The "going" price may be presumed to be one acceptable to a representative section of the industry, while the insertion of a condition invokes refund protection for the consumer.

they would refuse their gas to the interstate market, the Commission resorted to its second approach, 17 FPC 880, which for brevity may be called the "deferred regulation approach".

Perhaps because of the apparent administrative ease of this deferred regulation approach it was soon elevated to a rule of law governing the bulk of certificate proceedings, including all of those involving the present respondents. The Commission's action amounted in effect to an abdication or at least an indefinite postponement of regulation. See R. 17; 23-24; 132-37; compare R. 145-52; see also 20 FPC at 298.

B. The "Deferred Regulation Phase" of the Present Case.

Looking at the history briefly recounted above it is obvious that had the Commission followed consistently its approach in the *Signal* case initial prices in all areas including South Louisiana would have been conditioned initially at 1954-56 levels.[7] Further rate increases which *arguendo* might be called for by the financial requirements of the industry would then have been sought solely under § 4 of the Act, which provides for suspension of increased rates and refund protection for the consumer. A hearing under § 4, possibly consolidated with one under § 5, would have provided a forum for the presentation of any evidence relevant to the justness and reasonableness of rates. It is not impossible that such a regulatory scheme could have whetted the desire of producers for speedy determination of such rate proceedings in order to eliminate refund obligations and secure finally the higher prices to which they have consistently contended they are entitled.

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7. In Louisiana the weighted average price at the wellhead for all sales in interstate commerce was 9.7¢ per Mcf in 1954. *Sales by Producers of Natural Gas to Natural Gas Pipeline Companies*, 1961, 1963, pp. 5, 8. There were very few new sales at substantially higher prices.

Unfortunately, the results were otherwise, particularly in South Louisiana, where well-head price inflation was most exaggerated. A newly constituted Commission in 1956-59 took a rather different view of § 7 from that of the majority in *Signal*. By this time it was necessarily clear to producers that final rate decisions under Sections 4 and 5 would be long delayed, and this cannot have been a wholly unwelcome prospect because of the nonrefundable dollars collected during the pendency of the proceedings. Thus, a premium was placed upon obtaining as soon as possible a permanent certificate under § 7 at the highest price possible. Once permanently certificated, the high price could be collected, regardless of its justness and reasonableness under Sections 4 and 5, until a proceeding under those Sections was completed—a prospect which seemed unlikely before a half or more of the duration of those 20 year contracts had elapsed.

The present case is a direct product of the deferred regulation policy of the then-Commission, which had the unfortunate effect of making a regulatory statute the goad for exaggerated inflation. While this policy was in effect, prices, particularly in South Louisiana, rose and nearly doubled the 1954 level.[8] As each successive application at a new high came before the Commission it was certificated unconditionally at whatever initial price was set forth in the sales contract.

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8. The Fifth Circuit noted in one of the earlier appeals herein, that in 1954 pipelines were able to contract for new supplies of gas in South Louisiana at initial prices in the area of 12¢, *United Gas Improvement Co. v. FPC*, 290 F. 2d 133, at 136 (5th Cir. 1961). In the Fall of 1955, prices leaped to 17-18¢ when the Commission unconditionally certificated new sales to Transcontinental Gas Pipe Line at 16¢ plus 1¢ tax reimbursement, *A. J. Tamborello*, 14 FPC 123, and to Tennessee Gas Transmission Company at 17¢ plus 1¢ tax reimbursement, *Alabama-Tennessee Natural Gas Co.*, 14 FPC 986 at 992-94. The final leap, to 21½¢ plus 2¢ tax reimbursement, was precipitated by the Commission's June 1957 *Catco* order, but was set aside by this Court in *Catco*, 360 U. S. 378, and *Transco-Seaboard*, 361 U. S. 195, and by the courts of appeals in the subsequent UGI-New York Commission cases.

The present case is significant because it is the first case to reach this Court in which the Commission has returned to the proper *Signal* approach.[9] Unfortunately, this return to *Signal* first principles was not finally made until some four years after the original § 7 hearings in which the Commission decided to defer price considerations to vaguely promised future § 5 proceedings. The controversy herein arises essentially because at the outset of the hearing on remand the producer-respondents sought to offer in evidence a "tremendous mass of cost-type, economic, and financial evidence—consisting of approximately 70 exhibits and the testimony of 35 witnesses" (R. 495).

C. Recent History of the SIGNAL Approach: SKELLY.

The controversy is one of general importance. Following the series of reversals by the courts of appeals in these matters, discussed at p. 18, *supra,* the Commission returned, as it belatedly realized it must, to the *Signal* approach. During 1961 and 1962, the Commission had occasion to consider the initial price question in a number of varying cases: first, the *Catco* dockets on remand from this Court and, additionally, a number of cases which had not reached final decision by the Commission or in which rehearing of a deferred regulation approach had been ordered. Without at first drawing hard and fast rules as to the standard of proof required to demonstrate the public convenience and necessity the Commission on a case-by-case basis considered and disposed of whatever evidence might have been presented in all these cases. The cases, the type of evidence presented in them and the Commission's decisions on this evidence are set out in greater detail in Appendix "B" of this brief. The result of this Commission experience, first,

9. The remanded *Catco* case, in which a *Signal* approach was also applied, was settled after decision by the Commission. See 28 FPC 1090 (1962). This Court refused to review the subsequent *"Skelly"* decision, *Public Service Comm'n v. FPC,* 329 F. 2d 242 (D. C. Cir. 1964), *cert. denied sub nom. Prado Oil & Gas Co. v. FPC,* 377 U. S. 963.

confirmed the administrative soundness of the *Signal* approach, second, demonstrated the uselessness of cost and economic trend evidence, and, finally, revealed the interminable delay which would ensue if such evidence were generally permitted in the record.

In August, 1962, in *Skelly Oil Co.*, 28 FPC 401, the Commission, based upon experience gained in the preceding two years, took the occasion to formulate general rules as to the standard of proof in these interim initial price cases. The specific applications before the Commission involved sales from the southern part of the Texas Gulf Coast, but the issues raised were generally applicable in all initial rate cases. Therefore, the Commission, on the basis of its extensive regulatory experience to that time, held "in strong and unequivocal terms, that economic and financial evidence is generally not to be regarded as germane in resolving the initial price question in producer certificate cases" (R. 497). This major decision of the Commission was affirmed by the Court of Appeals for the District of Columbia in *Public Service Comm'n. v. FPC*, 329 F. 2d 242 (D. C. Cir. 1964), *cert. denied sub nom. Prado Oil & Gas Co. v. FPC*, 377 U. S. 963 (herein called *"Skelly"*). Since *Skelly*, the Commission has consistently applied what now may be called the *Signal-Skelly* approach in numerous cases. For convenience these are set forth and summarized in Appendix "C".

D. The "SIGNAL-SKELLY Phase" of the Present Case.

In the present case the Commission adopted the examiner's conclusion that the offered evidence:

> ". . . may be characterized roughly as falling generally into three basic categories, as follows:
>
> "1) *Cost of service studies* of various types. It may be noted that substantial portions of this evidence were defective in that they employed methods and techniques inconsistent with those

previously adopted by the Commission in *Phillips*, Op. No. 338, and CATCO, Op. No. 351.

"2) A number of *discounted cash flow studies*, similar to the one rejected by the Commission in CATCO, Op. No. 351.

"3) *Economic trend data studies* of various types, setting forth data related to drilling trends and costs, data related to supply, demand, revenues and profits, and market trend data.

"Certain of these studies were identical in nature with similar studies which the Commission in the *El Paso* certificate case, *El Paso Natural Gas Co., et al.*, Op. No. 358 (June 11, 1962), found to have 'no real probative value.'" (R. 556, 495) (footnote omitted)

The examiner refused to accept such evidence, both on the broad policy ground of the *Signal-Skelly* approach to initial price regulation and on the technical ground that the particular evidence as presented was "defective" (R. 495). His ruling was sustained by the Commission. The Commission adopted the following articulation by the Examiner of the *Signal-Skelly* approach:

"If this mountain of cost-type, economic and financial evidence had been received in the instant proceeding the instant hearing would, in effect, have amounted to the trial of some 16 different individual producer cost-type cases, and the decisional process required would have involved, in effect, the writing of some 16 different individual producer rate decisions. Any such proceeding would plainly have amounted to an administrative monstrosity. It would obviously have been completely contrary to the objectives emphasized in the Commission's instant order of March 7, 1962, *i.e.*, to obtain a prompt determination of the initial price question (and of the refund obligations of the producer applicants), by a limited proceeding on the basis of

> the 'ground rules' already established by the Commission in CATCO, Op. No. 351. In addition, any such procedure would have been completely inconsistent with the Commission's clearly expressed policy determination that producers rates are hereafter to be tried and decided on an area basis, rather than on an individual producer cost basis." (R. 556, 496) (footnote omitted)

Moreover, the Commission after "review of the record" (R. 556), adopted the examiner's specific reliance on the general principles laid down in the *Skelly* case. The examiner had noted that subsequent to his own ruling excluding cost-type, economic and financial evidence,

> ". . . The entire problem has been squarely resolved by the Commission in *Skelly* . . .", (R. 497)

and quoted at length from the *Skelly* opinion.

Thus the central issue in the present case is the proper administration of § 7 of the Natural Gas Act. It will be shown below that in its opinion here under review the Commission did not abuse its discretion in applying the *Signal-Skelly* approach, the history of which has just been outlined.

II.

THE PROPER EXERCISE OF THE COMMISSION'S POWER UNDER § 7 OF THE NATURAL GAS ACT.

A. The Scope of the Commission's Power Under § 7.

Section 7(c) of the Natural Gas Act provides:

> "No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or ac-

quire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations."

Section 7(e) provides:

"a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity."

And, additionally, § 7(e) provides:

"The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require."

The present case involves the effect to be given these provisions in regulating applications by producers-respondents to sell gas in interstate commerce from wells located in South Louisiana. The initial prices proposed for these sales were among the highest prices proposed for South Louisiana at the time certification was sought. Certain of the sales had the potential to trigger very substantial rate increases in existing contracts between one purchasing pipeline, Transcontinental Gas Pipe Line, and other producers supplying Transcontinental throughout South Louisiana.

Such triggering in fact took place in 1959 (R. 439-40), and consumers six years later are still paying resulting higher prices.

It has been established as the result of extensive litigation before the Commission and in the Courts of Appeals that the Commission must give such proposed prices careful scrutiny, *Catco,* 360 U. S. 378, at 391; must make "a real administrative effort to hold back prices", *Public Service Comm'n v. FPC,* 287 F. 2d 146, 150 (D. C. Cir. 1960), and has full power to impose a condition upon the issuance of certification reducing the initial rate. *Signal Oil & Gas Co. v. FPC,* 238 F. 2d 771 (3rd Cir. 1956), *cert. denied,* 353 U. S. 923; *Texaco Inc. v. FPC,* 290 F. 2d 149 (5th Cir. 1961). It has also been held that the Natural Gas Act confers on the Commission power to impose such a conditioned rate on the basis of a record containing only evidence of comparative field prices, where such evidence shows that the proposed price exceeds the general level of prices being negotiated at the time in the area. *Texaco Inc. v. FPC, supra; Skelly,* 329 F. 2d 242 (D. C. Cir. 1964).[10]

The appellate courts, preeminently in this Court's decision in *Catco,* have made increasingly clear the nature of the proceeding by which the Commission must carry out its responsibility under § 7. Either in reversing the Commission for failure to adopt a *Signal* approach, or in affirming its adoption of such an approach, they have been unanimous

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10. Given such power, had the FPC in 1957 and 1958 conditioned the certificates issued to the respondents herein to a level of 18.5¢ per Mcf plus 1.5¢ reimbursement for state taxes upon the records then existing in these cases, such an order would have been valid under the Natural Gas Act and, if appealed, would certainly have been affirmed by the courts of appeals. *Compare Texaco Inc. v. FPC, supra, with United Gas Improvement Co. v. FPC,* 290 F. 2d 133 (5th Cir. 1961), *cert. denied,* 368 U. S. 823. Of course, the Commission did not use its conditioning power when these proceedings were intitially before it. But this error on the part of the Commission, subsequently reversed, cannot place the respondents in a better position than they would have been in had the Commission acted properly in the first place.

in their requirements until the decision here under review. In *Catco* this Court said:

> "Where the application on its face or on presentation of evidence signals the existence of a situation that probably would not be in the public interest, a permanent certificate should not be issued." 360 U. S. at 391.

In *United Gas Improvement Company v. FPC,* 283 F. 2d 817 (9th Cir. 1960) the court said at 823:

> "In our view, however, a determination of relevancy for comparative purposes does not require examination into factors such as relative production costs which are not reflected in specific terms of the contracts. If this were required to implement the 'hold the line' technique, the procedure would assume much of the complexity of a rate adjudication. This would tend to defeat the objective of providing simple, direct and effective stopgap protection for the consuming public."

The Fifth Circuit itself in *Texaco Inc. v. FPC,* 290 F. 2d 149 (5th Cir. 1961) said at 157:

> ". . . [A] section 7 proceeding is not to be equated with a proceeding under section 4 or section 5 to determine a just and reasonable rate. The power and duty of the Commission . . . may be discharged by it without the elaborate and detailed proofs required in a section 4 or section 5 proceeding. We find that the record before the Commission meets the requirements of a section 7 determination . . ."

In *California Oil Co. v. FPC,* 315 F. 2d 652 (10th Cir. 1963) the Court of Appeals for the 10th Circuit, after quoting from the *United Gas Improvement Company* case cited above, stated at 659-60:

> ". . . [W]e also have serious doubts as to whether any of the costs or delivery services urged by Petitioner to sustain the initial price of 18.5 cents are rele-

> vant at all in determining the 'in line' price in a Section 7 proceeding. . . . We do not think that the Commission was required in this case to consider the exploration and drilling costs or cost of delivery services in arriving at the 'in line' price in a certification proceeding. The consideration of these matters may properly be left to a Section 4 proceeding."

Finally in *Skelly*, 329 F. 2d 242 (D. C. Cir. 1964), the Court of Appeals rejected the producer argument that they had a right to consideration of certain types of evidence under § 7. The court said at 246-47:

> "The standards of Sections 4 and 5 are not those to be used in conditioning a certificate issued under Section 7; otherwise the purpose of *Catco* to avoid the consequences of the well nigh interminable proceedings incident to a rate case would be defeated . . . consideration of the proffered evidence was not essential."

The nature and scope of § 7 proceedings which emerges from a consideration of these and other cases is unmistakable. While the courts do not limit the type and extent of evidence which the Commission may hear if it so decides, they clearly confirm its power to dispose of all issues arising under § 7 on the basis of a *Signal-Skelly* approach.

In *Skelly* the Court of Appeals went on to say:

> ". . . [W]e need not hold that the Commission may never consider such evidence if the circumstances in a particular case move it to do so consistently with its obligation under *Catco*." (p. 247)

This Court in *Catco* held that the Commission was not required to determine the justness and reasonableness of a proposed rate in the certificate proceeding. At the same time, the strong implication of the opinion is that the Commission lacked *power* to certificate an out-of-line price

absent a supportable finding that the price was just and reasonable.[11]

The corollary of *Catco* is not that the Act consequently confers on every applicant a right to a hearing under § 7 in which it may, if possible, prove that its proposed price is just and reasonable. Rather, the stress in *Catco* was on the use of the Commission's conditioning power to protect the consumer. Therefore, while the Commission may, if it chooses and the interest of the consumer is not jeopardized, examine justness and reasonableness under § 7, it clearly has authority under the Act to assign such rate matters to a separate rate case and to use its conditioning powers as an interim method of consumer protection. To suggest, as did the court below, that by means of undetailed "resourceful ingenuity" and undefined "administrative inventiveness" (R. 631-32) the Commission could have prevented the admission of the evidence proffered here from bogging this certificate case down into a full-dress rate hearing is totally unsupported and, as experience has shown, totally unrealistic.

The discretion as to the proper evidentiary forum must lie with the regulatory Commission, whose duty is the protection of the consumer as well as the producers, and not exclusively with the producer-applicant. The effective holding of the court below was to place this discretion in the hands of respondents and others similarly situated. The issue presented by this present case is not, therefore, the one articulated by the court below—the proper quantam and type of evidence admissible in a § 7 hearing.[12] The

11. See also *Oklahoma Natural Gas Co. v. FPC*, 257 F. 2d 634 at 652-53 (dissenting opinion), *cert. granted*, 358 U. S. 877, *cert. dismissed on petitioner's allegation of mootness*, 358 U. S. 948.

12. Such a controversy would lead this Court and the courts of appeals into a time consuming and fruitless exegesis of the rules of evidence. It would require them, as the Commission was required to do in this case, to study bulky technical exhibits (see e.g. R. 267-360) in order to weigh their substance, relevance and materiality. Obviously this is a job for the Commission and its examiners, not for the courts.

issue here is rather the much more far-reaching one discussed above of the proper approach to total regulation under the Natural Gas Act.

For a number of years and through a number of proceedings the Commission examined and considered many various types of evidence presented by applicants under § 7 (see Appendix "B" *infra*). It ultimately concluded that when such so-called economic and cost evidence was fragmentary in nature, it was obviously unrepresentative and of no use. On the other hand a full presentation of such evidence would be duplicative of the proceeding in the cognate area rate case.

B. The Decision Below Would Mark a Return to Inadequate Consumer Protection Under § 7.

After this Court and the courts of appeals reversed the Commission's policy of issuing unconditioned certificates upon inadequate records there followed, as discussed above, a period of hesitation and confusion in the Commission's actions. Hearings on certificate applications which had not as yet culminated in Commission opinions were set for rehearing or reopened for further evidence. See cases cited in Appendix "B". The various dockets remanded by the courts were consolidated with area rate proceedings and allowed to "ride along" with those proceedings for ultimate decisions which were obviously to be long delayed.

However, producer-applicants still desired to put their gas on the market and pipelines sought to purchase. To permit this immediate flow of gas pending the delays and confusions described above the Commission began to rely more and more upon that part of § 7(c) of the Act which permits the issuance of "a temporary certificate in cases of emergency . . .".[13] Such certificates had the advantage from the point of view of sheer speed of processing (though hardly from that of consumer protection) of being

13. See 1963 FPC ANNUAL REPORT, pp. 128-29.

issued *ex parte* without notice or hearing.[14] This practice contained the latent potential for permitting the Commission to carry out the very policy of unconditioned certification which the courts had universally condemned in the area of permanent certification. It had the added "advantage" for purposes of supposed expedition that consumer representatives had no notice of the action until after it was taken. A consumer representative finally came upon one of these *ex parte* certificates within the statutory 30-day period, § 19(b), and appealed it. The Commission's power was upheld,—though only upon a theory that the action, being purely provisional, was subject to necessary adjustment at the time of permanent certification. *Public Service Comm'n. v. FPC*, 327 F. 2d 893 (D. C. Cir. 1964).

Given this court-approved "emergency" practice,[15] it becomes obvious that the problem which concerned this Court in *Catco* would, if the decision of the court below were to prevail, be perpetuated in only slightly altered guise—but a guise far more deadly to the consumer interest. Thus, if in a hearing for a permanent certificate evidence of the sort offered herein below, but not received in evidence, is now to be heard, cross-examined and rebutted, § 7 proceedings will become as "nigh interminable" as the rate proceedings discussed in *Catco*—indeed they will necessarily be rate hearings of the sort discussed in that case (see R. 496). At the same time producers could be

14. This Court is familiar with and has condemned the process. *FPC v. Hunt*, 376 U. S. 515.

15. Although § 7(e) of the Act uses the word "emergency" without exegesis, the Commission has since 1956 distinguished sharply between those "emergencies" justifying the issuance of temporary certificates to pipelines on the one hand and to producers on the other. The facts compelling issuance of a temporary certificate to a pipeline generally fall within the more usual meaning of the word "emergency". See *Algonquin Gas Transmission Corp. v. FPC*, 201 F. 2d 334 (1st Cir. 1953). In contrast, the Commission's regulations permit issuance of temporary certificates to producer-applicants on the basis of unsupported allegations of conditions that amount to no more than normal business exigencies, such as the necessity to pay shut-in royalties and to flare gas. See, *Public Service Comm'n v. FPC*, 327 F. 2d 893 (D. C. Cir. 1964).

collecting their full contract rates, unjustified, under temporary certificates subject at best only to refund protection and that, apparently, only upon certain contingent equities. *Skelly*, 329 F. 2d at 250.

On the other hand, if the Commission should condition such temporary certificates, it would have to do so on some such "arithmetic" basis as Judge Brown deprecates in his opinion below, or the goal of expedition would necessarily be lost. Judge Brown himself, speaking for the Fifth Circuit in *Hunt v. FPC*, 306 F. 2d 334, 339-40 (5th Cir. 1962), *rev'd on other grounds*, 376 U. S. 515, has refused to upset such an approach to conditioning temporary certificates. Thus the Opinion below inevitably relegates the crucial consumer protective regulatory act to an *ex parte* procedure from which consumer representatives are barred. Clearly, the Natural Gas Act does not require this result reached by the court below.

III.

THE PROPER CONDITIONING LEVEL.

The court below declined (R. 641) to pass upon the Commission's findings as to the going price level for South Louisiana at which a consumer-protective condition in the applicant's certificate might be made. The issue was ripe for decision by the court below and no party contended that further evidence as to field prices was called for by the record. Indeed, sufficient evidence of this kind had been in the record in the first stage of the *Transco-Seaboard* and *Hope* cases (R. 398).

The Commission, Petitioner to this Court in No. 24, has stated in its Petition for a Writ of Certiorari that it will argue the propriety of the Commission's "in-line" holding and the Commission is clearly the proper party to make such an argument in detail. Therefore it need only be pointed out here that the law in the area and the record in the present case fully support a summary affirmance of the Commission by this Court on the "in-line" issue.

The standards governing appellate review of a discretionary finding such as the Commission's in-line finding below are clearly set forth by various courts of appeals. If the finding is supported by the evidence of record then the court cannot substitute its own judgment for that of the Commission. In *California Oil Co. v. FPC*, 315 F. 2d 652 (10th Cir. 1963), the court held:

> "Here, the Commission issued a conditional certificate requiring a lower initial sale price. Therefore, our review of the order in question is confined to a determination, from the record, of whether the prescribing of such condition is supported by soundly based findings, or, stated in another way, whether it is supported by substantial evidence when measured by the foregoing standards." (p. 657)

In *Atlantic Ref. Co. v. FPC*, 316 F. 2d 677 (D. C. Cir. 1963), the court held:

> "Considering the record as a whole we are not able to say that the Commission abused its discretion in conditioning the certificates of convenience and necessity in this case." (p. 680)

Similarly in *Skelly:*

> ". . . [S]ince the data relied upon adequately supports the price condition of the permanent certificates such condition is approved." (329 F. 2d at 247)

The evidence relied on by the Commission herein and summarized in the examiner's decision (R. 499-509) supported the Commission's determination of an in-line price of 18.5¢ per Mcf plus 1.5¢ tax reimbursement where applicable. The area for exercise of the Commission's discretion was particularly limited in the case of the present applications, which were near contemporaries of the *Catco* sales. The Commission had only recently and at great length evaluated the evidence of going prices in South Louisiana in *Continental Oil Co.*, 27 FPC 96 (1962) (*Catco*-on-remand). In

the present case therefore it was not evaluating data new or unfamiliar to its expertise but rather examining the narrower question of whether the present record required any departure from the *Catco* decision.

Thus under the criteria laid down by the courts of appeals the determination of the Commission below as to the proper in-line price was rational and based on substantial evidence of record. This Court may find that the conclusion reached was within the Commission discretion. By now exercising its power to so hold, this Court may provide the consumer at once the protection which has been awaited since 1958-59 and which the Commission below properly sought to provide.

IV. In Order to Carry Out the Mandate of the Several Courts of Appeals Reversing Unconditional Certification, the Commission Was Required, on Remand, to Correct Its Earlier Error by Requiring Refunds, With Interest, of Excess Amounts Collected Pursuant to the Invalid, Judicially Reversed, Certificates.

Following the Commission's original unconditional certificates in September 1958 and August 1959, timely review proceedings, challenging the initial price level, were instituted by one or more of the present Petitioners. Even though those review proceedings were pending the producers, nevertheless, began their sales at the 23.55¢ prices. For the most part, these sales began during 1959, so that by the time the Commission decided the remanded proceedings, in mid-1963, the producers had been collecting their out-of-line prices for some four years while the invalidity of the underlying certificates had been declared by the courts for some three. In all instances, the effect of these increased prices had been passed on by the pipeline purchasers to their customers.

Accordingly, when the Commission determined, in the order now under review, that the appropriate in-line price was 20¢ and that permanent certification should be conditioned upon the filing of an initial price of 20¢, it also

concluded, as indeed it was obligated to, that its original certifications in 1958 and 1959 should have been conditioned at the in-line level of 20¢ and that the amounts which the producers had collected pursuant to the judicially reversed certificates in excess of that level should be refunded, together with appropriate interest.

That result was the whole point of the original appeals and of the reversals—which were predicated upon the proposition that the Commission had failed to exercise its regulatory authority over these sales and was being given a second chance to do so. In *Catco* this Court held that Congress intended, in enacting the Natural Gas Act, to provide a *complete, permanent,* and *effective* bond of protection for the consumer. 360 U. S. at 388. It is equally clear that this bond of protection was intended to be effective "from the time the gas first enters interstate commerce." *Atlantic Ref. Co. v. FPC,* 316 F. 2d 677, 679 (D. C. Cir. 1963). This Court reversed the Commission in *Catco* expressly because the unconditioned certification of the out-of-line price, though subject to prospective reduction after a subsequent § 5 rate hearing, would, since "without the protection of refund," 360 U. S. at 390, confer a windfall on the producer to the detriment of the consumer. If the producers were nevertheless permitted to retain the excessive prices collected under the invalidated certificates the decisions of this Court and the courts of appeals in these initial price cases would be rendered largely hortatory.

The court below properly recognized these principles (R. 638-39). However, it substituted its own "equitable" standard of consumer protection for that of the Commission by "open ending" the producers' refund obligation. While the Commission's findings in the Permian Basin area rate case indicate that the just and reasonable rate which the court below would use as the basis for measuring refunds will be well below 20¢ per Mcf (see p. 7, *supra*), the fact of delay in requiring refund is a detriment

to consumers, *FPC v. Tennessee Gas Transmission Co.*, 371 U. S. 145, 154-55, and thus presents a balancing consideration. Since, as noted in footnote 10, *supra*, producer-respondents should now be in no better position than they would have been had the Commission acted correctly when the matter first arose, the refund required down to the 20¢ level is an appropriate remedy.

The *sua sponte* substitution of a regulatory scheme of its own devising was error on the part of the court below. *FPC v. Colorado Interstate Gas Co.*, 348 U. S. 492. Moreover, the standard used by the Commission in this case was reasonable and the one uniformly used by the Commission, whether dealing with invalid rate filings under § 4(e), *Shell Oil Co.*, 29 FPC 472 (1963), *aff'd sub nom. Shell Oil Co. v. FPC*, 334 F. 2d 1002, 1008 (3rd Cir. 1964), invalid permanent certificates on court remand, *Continental Oil Co.*, 27 FPC 96 (1962) (*Catco*-on-remand); *Socony Mobil Oil Co.*, 27 FPC 347 (1962), or temporary certificates, *Hunt Oil Co. v. FPC*, 334 F. 2d 474 (5th Cir. 1964). In these cases the criterion of justness and reasonableness has not been considered relevant to the issue.

The effect of the court's decision making justness and reasonableness of rates a criterion in ordering refunds would inevitably be either to turn all certificate proceedings into rate hearings or to defer the ordering of refunds until the conclusion of subsequently instituted rate hearings. Either result would effectively lessen the bond of protection which refunds offer the consumer. *FPC v. Tennessee Gas Transmission Co.*, 371 U. S. 145, 154-55. Finally, the ordering of interest was necessary to prevent unjust enrichment and to effectuate the purposes of the Act. *Texaco Inc. v. FPC*, 290 F. 2d 149, 157 (5th Cir. 1961).

V. The Commission Had Power to Impose a Limited Moratorium to Prevent Triggering.

In *Catco* this Court said:

> "Where the proposed price is not in keeping with the public interest because . . . its approval might

> result in a triggering of general price rises . . . the Commission in the exercise of its discretion might attach such conditions as it believes necessary." (360 U. S. at 391)

In this connection the Commission herein found:

> "An examination of the applicable contracts to Transco, Hope and United reveals that triggering and price redeterminations will take place at a price in excess of 23.55 cents per Mcf." (R. 578; compare R. 439-40)

The Commission therefore imposed as a condition to certification a limited moratorium on rate filings above 23.55¢ per Mcf—until July 7, 1967 or the completion of the South Louisiana Area Rate proceeding, whichever is earlier.

The condition thus imposed was far less sweeping than the one upheld by this Court in *FPC v. Hunt*, 376 U. S. 515. Moreover its purpose was more limited. The condition in *Hunt* was designed to freeze the *status quo* pending a hearing and decision on permanent certification regardless of the time it might take. The present condition, in contrast, was limited in duration, did not preclude all resort to § 4(e) but only if the price was above 23.55¢ per Mcf and was designed only to preclude a specific and serious threat to consumer interest—triggering of indefinite escalation clauses—which this Court has frequently recognized. *E.g., Catco*, 360 U. S. 378; *FPC v. Texaco Inc.*, 377 U. S. 33.

The power of the Commission to impose such a reasonable condition was squarely upheld by this Court in the very recent case of *FPC v. Hunt, supra*. This Court there clearly elucidated the interrelationship of §§ 7 and 4 of the Natural Gas Act, and a reargument of the issue would be superfluous here. The court below attempted to distinguish the *Hunt* decision on the basis of what it misconstrued to be a distinction made by this Court between conditioning temporary and permanent certificates. The language of the Act makes no such distinction, nor did this Court. The rationale of the *Hunt* case would apply with even greater

force to permanent certification, where any injury permitted to the consumer interest can only be remedied under § 5, which contains no refund mechanism.[16]

CONCLUSION.

For the foregoing reasons it is urged that the opinion of the court below be reversed and the orders of the Commission herein be affirmed in all particulars.

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16. The importance of the refund of part or all of a triggering rate has been expressly recognized by the Commission. In an order issued November 19, 1963 in *Texaco Inc.*, 30 FPC 1316, it held that rates triggered by the new levels erroneously approved in *Transco-Seaboard* (see R. 439-40) were subject to retroactive adjustment only to the extent that the triggering rate was so adjusted by refund. Review of this ruling is pending in *United Gas Improvement Co. v. FPC*, CADC No. 18339.

APPENDIX A.

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES.

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * *

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing

and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION.

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State,

municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

* * *

EXTENSION OF FACILITES; ABANDONMENT OF SERVICE.

* * *

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of

any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

* * *

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall

be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

* * *

REHEARING: COURT REVIEW OF ORDERS.

Sec. 19 . . .

(b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28,

United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, sec. 1254).

APPENDIX B.

"In-Line" Cases (1962-63) Evaluating Cost, Economic and Other Evidence.

In 1962 and 1963 the Commission considered the various types of cost and economic evidence presented in a number of "in-line" cases involving various areas. The following cases all involved applications for certificates of public convenience and necessity under § 7 of the Natural Gas Act. In each the Commission, after receiving the cost and economic evidence and examining it, found it of no aid and therefore conditioned certificates upon a lower initial price on the basis of field price evidence:

Continental Oil Co., 27 FPC 96 (1962) (*Catco*-on-remand). In this remanded *Catco* case the applicants introduced considerable cost evidence. The Commission found the evidence, while extensive, to be incomplete and useful only for rough comparative purposes. It said:

> "It is clear enough that the cost of service evidence here is not complete as presented by any of the parties. In the first place the evidence relates to Continental alone and not to the other Catco companies. Furthermore, it combines Continental's production costs for the Cameron area leases with Continental's system-wide exploration costs. While the incomplete nature of the evidence makes it impossible to make a definite finding as to cost of service, it does provide a basis of comparison with the field prices which may assist us in determining whether the proposed initial price meets the standards of the Act." (p. 103)

Socony Mobil Oil Company, Inc., 27 FPC 347 (1962). This decision involved one of the dockets remanded by this Court in *Transco-Seaboard*, 361 U. S. 195. The type of

evidence presented by applicants and found inadequate by the Commission is indicated by the following:

> "Finally, Socony presented historical cost evidence purporting to show a direct allocated unit cost of 30.79 cents per Mcf for this High Island gas alone. Socony filed no brief and has not attempted to expound a proper policy which might utilize such cost data, even were we to accept Socony's calculations. In our judgment, it is not feasible to use the cost figures adduced by Socony in redetermining this case. The results of attempting to determine 'costs' for each field are too well known to bear extended discussion. As staff points out the ratio of intangible drilling costs, presented by Socony for the 7 productive High Island wells, to the reserve estimates for the pools in which these wells are completed vary from 1 cent per Mcf to 89 cents per Mcf. A system of regulation based on field-by-field cost studies would unduly depress prices in 'bonanza' fields—upon which the public heavily relies—and approve excessive prices for marginal production.
>
> "Our regulation of producers teaches us that costs should be considered only for aggregates large enough to reflect representative conditions of properties. We cannot, here, find the estimated High Island reserves of some 50 million Mcf sufficiently large to give High Island costs any significance standing alone. Since Socony has made no attempt to demonstrate that its isolated cost experience at High Island is representative of experience for other properties, other operators and significant volumes of production in the area, we cannot soundly give any weight whatever to its 'cost' showing, and we need not do so. See *Covington & Lexington Turnpike Co. v. Sanford,* 164 U. S. 578, 596; *San Diego Land & Town Co. v. Jasper,* 189 U. S. 439; *Baltimore & Ohio Rail Road Co. v. United States,* 345 U. S. 146." (p. 348)

Michigan Wisconsin Pipe Line Co., 27 FPC 449 (1962). This case involved sales from Northwest Oklahoma. The applicants presented considerable geological and cost evidence as summarized in the Examiner's decision, 27 FPC at 476-77. The Commission found:

> "Although the parties have gone to great lengths to justify the proposed initial price on the basis of comparative cost evidence and evidence to show the geological, operating and marketing characteristics of the Woodward area in relation to the Laverne area, this evidence is not of such compelling nature as to convince us that we should depart from the pricing pattern established in the Policy Statement by ordering either an adjustment in price or in area boundaries on the basis of the record in this individual certificate proceeding." (p. 454)

The Ohio Oil Company, 27 FPC 551 (1962), *aff'd sub nom. Atlantic Refining Co. v. FPC*, 316 F. 2d 677 (D. C. Cir. 1963). The applications in this case involved sales in North Louisiana. The Commission analyzed the evidence presented as follows:

> "There is no evidence in the record to justify the 18.5 cent prices on the basis of costs. No conclusion whatever can be drawn from Hunt Oil Company's fragmentary 'economic study' of its two production units involved herein, which purports to show costs of about 7 cents per Mcf for one unit and about $5.80 per Mcf for the other (now abandoned). The inferences made by Hunt from the proceedings in Docket No. G-9554, et al. and Docket No. G-9065, et al. are unwarranted since neither case considered the costs of the sales herein. The applicants' evidence as to increasing risks in North Louisiana was general in nature and cannot be translated into a specific level or range of costs for these sales." (p. 552)

The Commission's refusal to consider this economic and cost evidence was affirmed by the Court of Appeals.

El Paso Natural Gas Co., 27 FPC 1134 (1962). The sales involved in this proceeding were from fields in Southwestern Wyoming to El Paso Natural Gas Company. Producer applicants introduced extensive economic and trend evidence. Much of it was identical in nature with evidence presented but rejected in the present proceeding (R. 556, 495). The Commission analyzed this evidence at length and concluded that for initial price purposes it had "no real probative value". The Commission said:

> "To justify their proposed contract price in this proceeding, the producers have presented an economic study which purports to show the reasonable financial requirements of the industry. This economic evidence consists of charts and tables setting forth certain supply, demand, cost, revenue, and market price trends based on data compiled from the Census of Mineral Industries, United States Bureau of Mines, Mineral year book, and various trade publications for (1) the entire United States; (2) the States of Colorado, Montana, Utah and Wyoming; (3) the States of Kansas, New Mexico, Oklahoma, and Texas; and (4) a combination of the eight named western states.
>
> "The producers' witness, in presenting the foregoing evidence, stated that costs incurred by the producers for the specific supplies committed to El Paso in this proceeding are meaningless for the purpose of testing the appropriateness of the initial price, and that the appropriate price must be determined on the basis of the financial requirements of the industry as related to certain trends on an area basis. In his opinion, however, industry revenue requirements cannot be related to area prices except through the mechanics of the competitive market system. Thus the producers take the position that because the trends

presented show a decline in productivity per foot drilled, an increase in cost of production, and a decline in the ratio of new supply to net production, present gas prices are not high enough to furnish producers with the incentive to find, develop, produce and market sufficient quantities of gas to meet consumer demand; and that prices should be allowed to increase until they are high enough to bring forth the supplies needed to equal demand and the foregoing trends are reversed.

"Under the theory advanced by the producers, the economic evidence presented could be used to justify any price which might be thought to be required as an incentive to bring adequate supplies of new gas to the interstate market, and which has been negotiated at arm's length in a competitive market. To accept the producers' contract price on this theory of regulation would be tantamount to an abdication of our regulatory responsibility under the Natural Gas Act. As stated by the Court of Appeals for the Fifth Circuit in *U. G. I. v. F. P. C., supra,* '. . . the only justification for giving the Commission the duty to regulate prices was the determination by Congress that the producers have a supply that is so restricted in relation to demand that they have the economic power to bargain for prices that will be injurious to the public.' To preside over a rising spiral of prices as dictated by competition in the open market and the trends associated with that market is to forego regulation of producer prices in the public interest, and would hardly be consistent with that 'real administrative effort to hold back prices' which the Supreme Court of the United States has demanded of us. See *P. S. C. v. F. P. C., supra.*

"The evidence presented by the producers in this proceeding offers no substantial, let alone compelling, proof of the public's need to have the gas supplies here

involved certificated for sale at the proposed contract price, or any initial price in excess of the in-line price of 15.384 cents per Mcf. The evidence does not show that the 15.384-cent price is inadequate to stimulate continued exploration and development of new reserves in Wyoming. The trends portrayed in the economic study presented by the producers do not necessarily bespeak the necessity for us to provide an increased incentive for exploration and development in the Wyoming Area or more particularly in the Green River Basin of southwest Wyoming where the gas in this case is being produced. As noted before, the gas purchased by El Paso in southwest Wyoming is delivered to markets served by its Pacific Northwest pipeline. However, no evidence as to the demand for gas in these markets has been presented, nor is there a showing that the development of new reserves to serve these markets is not progressing at a rate sufficient to meet the present or future needs of the area. On the other hand there is evidence to show that price levels in the four Mountain States have been adequate consistently to call forth new reserves which are more than double the production of the region; and that El Paso is apparently satisfied that exploration in this area is going along as well as can be expected.

"With respect to the use of trend evidence, it is impossible to draw any easy conclusions as to what particular trends may mean in terms of price. Thus a trend which shows reserves increasing at a declining rate in relation to the demand for gas does not require a conclusion that there is insufficient price incentive and profit potential. Exploration and development may well be continuing at a reasonable pace, even though the discovery of new reserves may appear to lag behind the demand for additional gas. Furthermore, any judgment with respect to the rate of exploration and development since 1954, as indicated by historical

trends, must be tempered by the understanding that such trends reflect in some degree past uncertainty among producers as to the course which producer regulation would take after the Supreme Court's decision in the Phillips case.

"The trend evidence presented by the producers in this proceeding is not sufficient to permit us to draw any conclusions therefrom with respect to the initial contract price here proposed. Without some substantial proof of how this general economic data, applicable to the industry as a whole over wide geographical areas, can be related to and utilized in support of the specific price proposed for these sales in this particular area, such evidence has no real probative value." (pp. 1137-38) (footnotes omitted)

Standard Oil Company of Calif., 27 FPC 353 (1962), *aff'd sub nom., California Oil Co. v. FPC*, 315 F. 2d 652 (10th Cir. 1963).

This case involved sales from newly developed fields in Utah to El Paso Natural Gas Co. At the hearing intervenors representing California consumers urged to the Examiner that the Natural Gas Act requires as a matter of law that the applicants introduce "some evidence as to the costs incurred in the production of the Red wash gas . . ." 27 FPC 1171-72. The Examiner held: "evidence of producer costs has never been held by the courts to be necessary to the determination of initial prices consonant with the public convenience and necessity." The California intervenors excepted to this ruling of the Examiner, 27 FPC 1156, but the Commission denied the exception. This ruling was affirmed by the Court of Appeals. The Commission's action in rejecting this evidence was affirmed by the Court of Appeals which held:

"We do not think that the Commission was required in this case to consider the exploration and drilling costs or the cost of delivery services in arriving at the

'in line' price in a certification proceeding." 315 F. 2d at 660.

Transwestern Pipeline Company, 28 FPC 109 (1962). This case is one of particular interest. It involved proposed sales from the West Texas-Permian Basin area and the Panhandle-Hugoton area to Transwestern Pipeline Company. On August 10, 1959 the Commission issued certificates to the producers involved in this case conditioned upon a lower initial price. However, by order on rehearing issued September 23, 1959, the Commission concluded:

> ". . . that the producers should be given the opportunity at an early date in proceedings supplemental to these certificate proceedings, to introduce such further evidence as they deem desirable in the light of the *Catco* decision, including evidence of costs, to show that their proposed initial contract prices meet the test of the public convenience and necessity." 22 FPC at 544.

Further proceedings were held which concluded with the opinion reported at 28 FPC 109. The type of evidence introduced by the applicants at the reopened proceedings is summarized by the Examiner as follows:

> "Acting upon petitions for review of orders of the Federal Power Commission the Court of Appeals for the Fifth Circuit in *Texaco, Inc. v. Federal Power Commission,* 1961, 290 F. 2d 149, 157 said 'The power and duty of the Commission to give' most careful scrutiny and reasonable reaction to initial price proposals of producers 'may be discharged by it without the elaborate and detailed proofs required in a Section 4 or Section 5 proceeding.'
>
> "The producers herein went to great lengths to justify their proposed initial prices by comparing their sales to Transwestern with the Laverne Field sale by

Socony Mobil to Michigan Wisconsin, by evidence intended to show the level of the conditioned prices would reduce the drilling incentive necessary to develop the various fields in the areas, by evidence of expenses for purchasing, holding, exploring and developing lease holdings in the several areas, by evidence tending to show an 'engineering test of cost' (Richardson & Bass, G-16137), by evidence tending to show the cost of an average well to develop a cash flow rate of return, by evidence tending to show increased costs and the need for higher prices to induce further exploration and development, and by evidence to show a company-wide cost-of-service study by Gulf. This evidence having been carefully considered, is not of such a compelling nature as to convince this Examiner, by a preponderance of the evidence, the public convenience and necessity requires these sales at a price level higher than that to which they were conditioned by the Commission, except in the single instance of the sale by Warren from its Sitter Plant hereinabove considered. The prices as conditioned by the Commission were based upon and reasonably related to, except in G-16030, prevailing prices for wellhead sales of pipeline quality gas as theretofore certificated by the Commission." (p. 124)

The Commission found that its original decision conditioning the certificates was unaffected by the evidence introduced by the applicants, stating:

"We find that a large part of the evidence subsequently submitted was cumulative and constituted little more than a restatement of evidence presented and considered in the initial proceeding. The evidence brought forth does not convince the Commission that the public convenience and necessity requires initial prices different from those set forth in our original order upon which the certificates issued said producers were conditioned." (p. 112)

Finally in the leading case of *Skelly Oil Co.*, 28 FPC 401 (1962), discussed at length in the text of this brief, the Commission examined the extensive cost type evidence placed in the record by certain of the applicants and concluded that it could give such evidence no weight at all in reaching its finding as to the proper initial price required by the public convenience and necessity. It said:

> "As already indicated Texaco and Continental have introduced additional economic and financial evidence to justify their proposed prices of 16.4965 cents and 16 cents respectively. Texaco's evidence is designed to show the replacement cost of the gas which it sells. It presents industry-wide cost trends and also data on the costs of replacing gas consumed for the United States as a whole and for the Texas Gulf Coast area, using a variety of statistical sources and employing a number of estimates based on judgment. To some extent the results depend on the future demand for gas, for Texaco introduces a factor so as to include not only the cost of replacing the present gas consumed but also additional gas necessary to meet future needs. Thus under Texaco's theory the present consumer would, in effect, be burdened not only with the cost of the already-discovered gas he now consumes, plus at least some of the cost of replacing it, but also with costs associated with the discovery of additional volumes of gas based upon future demand trends. From the country-wide and area-wide data Texaco then attempts to draw similar conclusions with respect to its own financial needs by comparing its exploration and drilling costs with the industry figures.
>
> "In support of its presentation Texaco quotes the *Phillips* case[21] which states in effect that our ultimate objective will be the determination of fair prices for gas based on the reasonable financial requirements of

21. 24 FPC 537, 547.

the industry. It argues that by 'reasonable financial requirements' we mean the revenues required by the producing industry from sales of natural gas in order to provide funds sufficient to search for, develop and produce gas supplies adequate to meet the continuing demands of the public for gas. In our opinion these observations and Texaco's evidence are not germane to this certificate proceeding. The principal criterion that should be employed here is whether the proposed prices were 'in line' at the time of contract execution as required by the Supreme Court's *CATCO* opinion.[22] Texaco's observations and evidence may have an important bearing on determinations to be reached in an area rate proceeding, or might be relevant in an individual company rate case although they fall short of showing Texaco's costs. However, we do not think it necessary or appropriate in a certificate proceeding to consider evidence of area costs or financial requirements, or of individual company costs or financial requirements. Any such approach is of limited utility[23] and leads to complicated, long-drawn-out proceedings, detrimental to the public.

"Questions concerning the cost of replacing present reserves, and more particularly whether such costs should be borne by present customers or by venture capital are not questions to be decided in a section 7 certificate proceeding. Rather, they are central questions to be decided in area rate proceedings.

"We therefore hold that cost of service and financial requirements evidence normally is not relevant in producer certificate cases and that the initial price in such proceedings shall be determined by the 'in line' price in the area at the time the producer contract in

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22. *Atlantic Refining Co. v. P. S. C.*, 360 U. S. 378.

23. See *Continental Oil Co., et al.*, 27 FPC 96, Opinion No. 351, Docket No. G-11024, *et al.*, issued January 22, 1962.

issue was executed and by our guideline ceiling price for the area. We do not mean to foreclose the possibility that a producer may present compelling circumstances in a particular proceeding to justify a higher price, but we wish to emphasize that with the guidelines herein established the price issue in certificate cases should be handled expeditiously and that before any evidence which would customarily be presented in establishing a just and reasonable rate can be admitted in evidence, a convincing showing must be made that such evidence is essential to the just disposition of the price question.

"Obviously, we cannot permit every individual certificate case to be converted into a full-blown rate case; the proof in this proceeding demonstrates the lack of utility of a limited cost of service presentation. The evidence does not show the cost of present reserves and consequently does not indicate the price necessary to cover such costs and provide a return which will attract sufficient risk capital to undertake the exploration and development necessary to replace present gas reserves.[24] More generally, the evidence does not demonstrate the 'financial requirements' of Texaco or the other producers in this proceeding, for the relation of individual needs to those of the industry in the country as a whole or in the area is not shown by the limited comparisons made. To correct those defects would require a complete rate case, which we have found not warranted in a certificate proceeding.

"Continental strives to support its 16-cent price in the Javelina Field by reference to its evidence showing that from 1946 to 1963 it would spend more than twice as much as it had realized or would realize. In fact, it

24. Compare *Panhandle Eastern Pipe Line Co. v. F. P. C.*, 305 F. 2d 763 (CADC, June 30, 1962), No. 16583 where in a rate case the court upheld the Commission in refusing to base rates on field prices or hypothetical development costs.

said it would have to receive $2.78 per Mcf in order to recoup its cash outlay. Apart from the question of the type of evidence appropriate in a certificate proceeding such narrowly limited cost data would not form a proper basis for appraising financial requirements. See *Socony Mobil Oil Company*, 27 FPC 347, Docket No. G-13780, February 9, 1962." (original footnotes included) (pp. 410-12)

The Commission's approach here was affirmed by the Court of Appeals, *Public Service Comm'n v. FPC*, 329 F. 2d 242 (D. C. Cir. 1964), *cert. denied* 377 U. S. 963.

As previously noted, Judge Brown in his opinion herein stated in his footnote 30:

> "For all we know the Commission received the proffered evidence, it would have held it to be wanting and that might well have been the end of the matter." (R. 632)

Ironically, the Commission did just that. Exceptions were taken to the examiner's exclusionary ruling; all the excluded evidence was a part of the record in the form of offers of proof under the Commission's rules; the Commission stated (R. 556) that it had made a "review of the record;" clearly it considered "the proffered evidence" and found it "wanting." In *Skelly* the producer evidence was formally admitted in evidence but was given no weight at all by the Commission in reaching its administrative decision because of insufficiencies of the sort enumerated in the numerous cases cited above. No doubt considerations of the same sort guided the Commission's determination to affirm rather than overrule the examiner's exclusion of certain evidence herein. Therefore, the unmistakable purport of Judge Brown's holding is that the Commission must now go through the sheer formality of receiving such nonprobative evidence and putting Staff and intervenors to the unnecessary expense and delay of rebuttal and cross-examination, but need give it no weight if, as its extensive

experience indicates, such evidence is not useful in administering interim initial price regulation. In an earlier decision, *Hunt Oil Co. v. FPC*, 306 F. 2d 359 (5th Cir. 1962), Judge Brown stated correctly that: "What the Natural Gas Act does not need is nit picking decisions on little picayunish points . . ." (p. 361). Yet the narrow evidentiary holding of the court below appears to be in practical substance nothing more than such a "picayunish" formality, while its potential adverse impact on § 7 regulation under the Natural Gas Act could be enormous out of all proportion.

APPENDIX C.

Cases Decided Since "Skelly" Applying a "Signal-Skelly" Approach.

The following cases, excluding the case here under review, have been decided by the Commission following its landmark *Skelly* opinion. In each the Commission has conditioned the issuance of a permanent certificate to a producer applicant upon the reduction of initial rate to an "in line" level. In most cases the Commission, following *Skelly*, excluded cost-type evidence from the record. In many of these cases appeals are pending in various courts of appeals challenging this action by the Commission; the geographical areas involved in the cases are indicated in parenthesis following the citation.

Texaco-Seaboard Inc., 29 FPC 593 (1963) (Texas Railroad Commission Districts Nos. 2, 3 and 4).

Jake L. Hamon, 29 FPC 784 (1963), *aff'd per curiam*, CADC No. 17922, et al., Feb. 11, 1964 (unreported) *cert. denied*, 377 U. S. 963 (Texas R. R. Dist. No. 4).

El Paso Natural Gas Co., 29 FPC 1175 (1963) (Panhandle Area, Oklahoma; Panhandle Area, Texas).

United Gas Pipe Line Co., 30 FPC 329 (1963), *appeal dismissed per curiam, sub nom. Gulf Oil Corp. v. FPC*, 330 F. 2d 824 (5th Cir. 1964) (South Louisiana).

Hassie Hunt Trust (Operator), 30 FPC 1438 (1963), *appeal pending sub nom. Margaret Hunt Hill, Trustee, v. FPC*, CA 5, No. 21886 (in abeyance pending decision of present case) (Texas R. R. Dists. Nos. 2 and 3).

Amerada Petroleum Corp., 31 FPC 623 (1964), *appeals pending sub nom. Sunray DX Oil Co. v. FPC*, CA 10, Nos. 7781, *et al.* (Texas R. R. Dist. No. 4).

Shell Oil Co. (Operator), Opinion 434, July 6, 1964, *appeals pending sub nom. California v. FPC*, CA 9, No. 19647, *et al.* (Arizona).

Union Texas Petroleum, Opinion 436, July 23, 1964 *appeals pending sub nom. Pan American Petroleum Corp. v. FPC*, CA 10, No. 7912, *et al.* (South Louisiana).

Sun Oil Company, Opinion 445, Oct. 26, 1964, *appeals pending sub nom. General American Oil Company of Texas v. FPC*, CA 5, No. 22259 (Mississippi).

Edwin L. Cox, Opinion 446, Nov. 17, 1964 (State of Oklahoma, other than Panhandle and Carter-Knox areas).

Martha Featherstone, Docket No. C164-591, *et al.*, order adopting Examiner's decision issued March 26, 1965, *appeal pending sub nom. Atlantic Ref. Co. v. FPC*, CA 3 No. 15463 (Wyoming).

H. L. Hawkins & H. L. Hawkins (Operator), Docket No. G-18077, *et al.*, pending before Commission on exceptions to examiner's decision (Texas R. R. Dist. No. 3).

Sinclair Oil & Gas Co., Docket No. G-16760, *et al.*, pending before Commission on exceptions to examiner's decision (Texas R. R. Dist. No. 2).

Turnbull & Zoch Drilling Company (Operator), Docket No. G-17960, *et al.*, pending before Commission on exceptions to examiner's decision (Texas R. R. Dist. No. 4).